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**Before the
FEDERAL COMMUNICATIONS COMMISSION
Washington, D.C. 20554**

Federal Communications Commission
Office of Secretary

In the Matter of)

Implementation of the Non-Accounting)
Safeguards of Sections 271 and 272 of the)
Communications Act of 1934, as amended)

and)

Regulatory Treatment of LEC Provision)
of Interexchange Services Originating in the)
LEC's Local Exchange Area)

CC Docket No. 96-149

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COMMENTS OF GTE

GTE Service Corporation and its affiliated
domestic telephone and interexchange
companies

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SUMMARY

Independent local exchange carriers should be classified as "non-dominant" in the provision of interexchange services. The test applied less than one year ago in the *AT&T Non-Dominance Proceeding* would preclude the FCC from classifying an Independent LEC dominant unless it could quickly acquire more than 55 percent of the market, successfully maintain rates higher than those charged by any other interexchange carrier ("IXC"), and sustain this position sufficiently long to recover any associated losses. There is no reasonable basis for concluding that this would occur.

Independent LECs, which would enter the market with virtually a zero share, plainly are in no position to achieve market power in interexchange services. The market is characterized by high supply and demand elasticities, low marginal costs, and large, well-established firms such as AT&T and MCI, all of which would militate against the acquisition of market power by Independent LECs.

Independent LECs' alleged "bottleneck" control of local access facilities does not affect this analysis. In the first place, dominant regulation of an Independent LEC's interexchange services would be irrelevant to the perceived problems arising from the alleged "bottleneck." Moreover, the so-called "bottleneck" no longer exists. Furthermore, the size, geographical dispersion of, and close federal and state regulation applied to, Independent LECs would further preclude any manipulating of access services to advance their interests in the interexchange market.

Not only should the Commission continue to find Independent LECs non-dominant in interexchange services, but it should also eliminate the *Competitive Carrier*

separate affiliate requirement. Absent a showing of dominance, a separate affiliate merely harms consumers by imposing unnecessary costs.

Congress specifically found separation unnecessary in the case of the GTE Telephone Operating Companies, and the characteristics of Independent LECs confirm Congress' judgment. Imposing a separation requirement on Independent LECs would merely handicap the Independent LECs in their efforts to compete effectively with the incumbent IXCs to which no such restriction applies.

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COMMENTS OF GTE

GTE Service Corporation ("GTE"), on behalf of its affiliated domestic telephone and interexchange companies, submits the following comments regarding Section VIII of the *Notice of Proposed Rulemaking* ("*Notice*" or "*NPRM*") in the above-captioned proceeding.¹ Although this *Notice* primarily addresses the implementation of Section 272 of the Telecommunications Act of 1996 ("the 1996 Act"),² which concerns the interexchange operations of the Bell Operating Companies ("BOCs"), the Commission is also reviewing its policies regarding the provision of in-region interstate,

¹ FCC 96-308 (released July 18, 1996). The FCC extended the deadline for comment on independent local exchange carrier ("Independent LEC") issues until August 29, 1996. DA 96-1281 (Policy and Planning Div. Aug. 9, 1996).

² Pub. L. No. 104-104, 110 Stat. 56, *to be codified at* 47 U.S.C. §§151 *et seq.*

interexchange and international services by Independent local exchange telephone carriers ("Independent LECs").³

GTE will focus its comments on the issues raised in Paragraphs 108 through 162, and particularly Paragraphs 153 through 162, which specifically concern Independent LECs. GTE submits that the Commission will promote competition in interexchange services only if it continues to apply non-dominant regulation to Independent LECs' interexchange services, and eliminates the existing burdensome separate affiliate precondition for non-dominant classification established in the *Competitive Carrier* proceeding.⁴ GTE is also submitting, as Attachment I, a Statement

³ The GTE Telephone Operating Companies ("the GTOCs") have long provided local exchange, exchange access and intrastate, intraLATA toll services. Early this year, GTE Long Distance, an affiliate of the GTOCs that satisfies the *Competitive Carrier* criteria, entered the interstate, interexchange services market as a switchless reseller and is classified as a non-dominant carrier. GTE Long Distance is also obtaining appropriate certifications to offer intrastate, interLATA services throughout the nation. Services of the GTOCs today are provided separately from the GTE Long Distance services. In addition, GTE Hawaiian Telephone Incorporated ("GTE Hawaiian Tel") is classified as dominant in the provision of international message telephone service ("IMTS"). GTE Hawaiian Tel owns the Micronesian Telecommunications Corporation ("MTC"), a carrier operating in the Commonwealth of the Northern Mariana Islands ("CNMI"). Today, MTC is regulated as dominant for local exchange, access and domestic interexchange services, and non-dominant in the provision of IMTS. As a consequence of the rate integration provisions of Section 254(g) of the 1996 Act, the CNMI will now be treated as interstate, rather than international, for long distance calling.

⁴ To qualify today for non-dominant status under the *Competitive Carrier* criteria, a separate affiliate must: (1) maintain separate books of account; (2) not jointly own transmission or switching facilities with the exchange telephone company; and (3) obtain any exchange telephone services at tariffed rates and conditions. *Competitive Carrier Proceeding*, 98 F.C.C.2d 1191, 1198 (1984) (Fifth Report and Order). In the *BOC Out-of-Region Order*, the FCC "clarified" that the *Competitive Carrier* separate affiliate is a "separate legal entity," although the

of Paul W. MacAvoy ("MacAvoy Statement"), Williams Brothers Professor at the Yale School of Management, that demonstrates empirically that Independent LECs are non-dominant in the interexchange services market.⁵

INTRODUCTION

The 1996 Act dramatically transformed telecommunications policy in the United States by establishing "a pro-competitive, de-regulatory national policy framework."⁶ In order to promote competition in the interexchange services market, Congress eliminated certain legal barriers that previously had restricted competition in the interexchange services market from local exchange carriers ("LECs").⁷

The Commission is currently considering, in CC Docket No. 96-61, whether to eliminate the *Competitive Carrier* separate affiliate condition for non-dominant

Fifth Report and Order itself nowhere specifically imposed such a requirement for the affiliate. *Bell Operating Company Provision of Out-of-Region Interstate, Interexchange Services*, Report and Order, CC Docket No. 96-21, FCC 96-288 at ¶22 (released July 1, 1996). ("*BOC Out-of-Region Order*")

⁵ GTE has also reviewed, and provides specific references to herein, the Statement of Professor Daniel F. Spulber, Thomas G. Ayers Professor at Northwestern University, which is attached to the Comments of the United States Telephone Association, also filed today. ("Spulber Statement")

⁶ See *BOC Out-of-Region Order* at ¶1, quoting S. Conf. Rep. No. 104-230, 104th Cong., 2d Sess. 1 (1996).

⁷ In particular, Section 601 of the 1996 Act superseded the *GTE Consent Decree* (which had required GTE to offer interexchange services only through an affiliate separated from the GTOCs) and the *AT&T Consent Decree* (which barred the Bell Operating Companies from providing interLATA services).

classification of Independent LEC *out-of-region* interstate, interexchange services.⁸ In this *Notice*, the Commission is considering whether, in view of the dramatic changes now sweeping the industry, there remains any need for it "to continue to classify an independent LEC as dominant if it provides *in-region*, interstate, domestic, interexchange services directly (rather than through an affiliate complying with the *Competitive Carrier* requirements)."⁹

As the Commission is well aware, three large interexchange carriers ("IXCs"), with an aggregate market share of approximately 85 percent and, operating as non-dominant carriers, currently control the interexchange market. Consistent with the deregulatory direction of the 1996 Act, the Commission should promote competition in that market by rejecting dominant classification of Independent LEC interexchange offerings under the criteria applied by the Commission without exception for many years, including in the recent *AT&T Non-Dominance Proceeding*.¹⁰ Likewise,

⁸ See *Policy and Rules Concerning the Interstate, Interexchange Marketplace: Implementation of Section 254(g) of the Communications Act of 1934*, Notice of Proposed Rulemaking, CC Docket No. 96-61, FCC 96-123 (released Mar. 25, 1996). See *Comments of GTE*, CC Docket No. 96-61, Part I (April 19, 1996). In its Comments, GTE demonstrated that there is no longer any justification for the separate affiliate requirement for either in-region or out-of-region interstate, interexchange services offered by Independent LECs.

⁹ *NPRM* at ¶157 (emphasis added).

¹⁰ See *Motion of AT&T Corp. To be Reclassified as a Non-Dominant Carrier*, Order, FCC 95-427, 11 FCC Rcd 3271 (1995) ("*AT&T Domestic Order*"); *Motion of AT&T Corp. To be Declared Non-Dominant*, Order, FCC 96-209, (released May 14, 1996) ("*AT&T International Order*"). The *AT&T Domestic Order* and *AT&T International Order* are collectively referred to herein as the *AT&T Non-Dominance Proceeding*.

Independent LECs also should be classified as non-dominant in the international market, except for routes on which they are affiliated with a foreign carrier having market power per the conditions established in the *Foreign Carrier Entry Order*.¹¹

In the case of the GTOCs, Congress has spoken dispositively; Section 601(a)(2) of the 1996 Act eliminated the restriction contained in the *GTE Consent Decree* that had limited GTE to providing interLATA services through an affiliate separate from the GTOCs,¹² thus making clear that the public interest does not require Independent LECs to provide interexchange service through a separate affiliate.

The time has now come for the Commission to eliminate the *Competitive Carrier* affiliate requirement as well, and to allow Independent LECs to achieve operational economies that will promote competition in a market currently characterized by exorbitant operating margins for the three largest interexchange carriers. Such a requirement not only harms consumers by raising prices but also puts Independent LECs at a distinct disadvantage to incumbent IXCs, such as AT&T and MCI, which

¹¹ *Market Entry and Regulation of Foreign-affiliated Entities*, 11 FCC Rcd 3873 (1995), *recon. pending*. These policies are codified at 47 C.F.R. §63.10(a).

¹² *See United States v. GTE Corporation*, 1985-1 Trade Cas. (CCH) ¶ 66,355 (D.D.C. 1985) ("*GTE Consent Decree*"). Section 601(a)(2) of the 1996 Act states:

Any conduct or activity that was, before the date of enactment of this Act, subject to any restriction or obligation imposed by the GTE Consent Decree shall, on and after such date, be subject to the restrictions and obligations imposed by the Communications Act of 1934 as amended by this Act and shall not be subject to the restrictions and the obligations imposed by such Consent Decree.

operate under no separate affiliate requirements. Handicapping new entrants in such a manner is clearly not in the public interest.

I. INDEPENDENT LECs ARE NON-DOMINANT IN THE PROVISION OF INTERSTATE, INTEREXCHANGE SERVICES (§157).

The Commission classifies as "dominant" – and applies full Title II regulation to – those carriers that it finds to have market power in an identified market. In the *Notice*, the Commission solicits comment on whether it should "continue to classify an Independent LEC as dominant if it provides in-region, interstate, domestic, interexchange services directly (rather than through an affiliate complying with the *Competitive Carrier* requirements.)"¹³

Notably, the *Notice* does *not* invite comment on whether an Independent LEC providing service through a *Competitive Carrier* separate affiliate should be treated as dominant; rather, consistent with the deregulatory direction of the 1996 Act, the FCC asks for comment only on whether to eliminate or to modify the separate affiliate condition for non-dominant status. GTE respectfully submits that Independent LECs should be classified as non-dominant in the domestic, interstate, interexchange market, both in-region and out-of-region, regardless of their corporate structure, and therefore that the *Competitive Carrier* separate affiliate requirement should be repealed for Independent LECs.

¹³ *NPRM* at ¶157.

A. The Relevant Market For Interstate, Interexchange Is Nationwide And Consists Of All Services.

The *NPRM* proposes to retain its current definition of the relevant product market for the interstate, interexchange services market.¹⁴ GTE concurs.

Geographic market definition is another matter. The Commission has historically defined the market as nationwide.¹⁵ The Commission proposes to abandon this approach and tentatively concludes

that we should evaluate an Independent LEC's point-to-point markets in which calls originate in its local exchange areas separately from its markets in which calls originate outside those areas, for the purpose of determining whether an independent LEC possesses market power in the provision of in-region, interstate, domestic, interexchange services.¹⁶

GTE submits that a finding of anything other than a nationwide geographic market would be an error under the present circumstances.

¹⁴ *NPRM* at ¶119. However, the Commission proposes to replace its long-standing economic analysis of product and geographic markets with an analysis borrowed from the Department of Justice/Federal Trade Commission 1992 Horizontal Merger Guidelines. Dep't of Justice and Fed. Trade Comm'n 1992 Horizontal Merger Guidelines, 4 Trade Reg. Rep. (CCH) ¶¶13,104 (1992). The FCC has not adopted the Horizontal Guidelines as rules. See *Craig O. McCaw*, 9 FCC Rcd 5836 at ¶10 n.27 (1994).

¹⁵ The FCC traditionally has applied a "reasonable interchangeability" test founded on the decision of the Supreme Court in *Brown Shoe Co., Inc. v. United States*, 370 U.S. 294 (1962). See generally Berresford, *Mergers in Mobile Telecommunications Services: A Primer on the Analysis of Their Competitive Effects*, 48 Fed. Com. L.J. 247 (1996).

¹⁶ *NPRM* at ¶126.

A finding of a nationwide market is consistent with economics theory, as Professor MacAvoy demonstrates,¹⁷ with a decade of FCC precedent, with the recent decision finding AT&T non-dominant, and with Section 254(g) of the 1996 Act, which mandates nationwide averaging of interstate, interexchange rates.

As GTE stated in its Comments in CC Docket No. 96-61, however, the Commission should not rule out the possibility that, in some changed circumstances, it may find a factual basis for defining a different geographic market. GTE therefore submits that the relevant market should be all domestic, interstate, interexchange telecommunications services until there is "credible evidence" that a lack of competition in a particular market is resulting in a carrier exerting market power to control prices or exclude competition. However, that credible evidence does not exist today.

If, nonetheless, the Commission decides to evaluate a carrier's market power on the basis of point-to-point markets, all IXC's should be subject to the same scrutiny for the presence of market power on certain routes. Formidable competitors such as AT&T and MCI, which are planning quick entry into the local exchange business, will have the same ability as some LECs to exert market power on particular routes.

¹⁷ See MacAvoy Statement at 16-18; see also Spulber Statement at 6 (noting that interexchange customers do not purchase services *à la carte*, but to all locations as one service).

B. Independent LECs Are Non-Dominant Under The Analysis That The Commission Has Applied In All Other Instances, Including That Applied Recently In *The AT&T Non-Dominance Proceeding*.

Since the *Competitive Carrier* proceeding, the Commission has defined "market power" as "the ability to raise prices by restricting output" and "the ability to raise and maintain price above the competitive level without driving away so many customers as to make the increase unprofitable."¹⁸ The Commission has traditionally considered a variety of factors in assessing whether a carrier has market power,¹⁹ and recently found AT&T non-dominant on the basis of these same factors. Applying this same analysis compels the conclusion that Independent LECs are non-dominant in the interstate, interexchange services market regardless of their corporate structure.

1. The Commission's finding that AT&T is non-dominant precludes a finding that Independent LECs could be dominant in the interexchange market.

Within the past year, the Commission held AT&T to be non-dominant in the interexchange services market for both MTS and IMTS. The MacAvoy Statement points out, in so doing, the Commission, applying the *Competitive Carrier* factors

¹⁸ *Competitive Carrier Proceeding*, 85 F.C.C. 2d 1 (1980) ("First Report and Order"); 95 F.C.C.2d 554, 558 (1983) ("Fourth Report and Order"), *vacated in part*, *AT&T v. FCC*, 978 F.2d 727 (D.C. Cir. 1992), *cert. denied MCI Telecommunications Corp. v. AT&T*, 113 S.Ct. 3020 (1993). As the *NPRM* notes, the Department of Justice/Federal Trade Commission's 1992 Horizontal Merger Guidelines similarly refer to market power as the ability to impose a "small but significant and nontransitory" increase in price. Dep't of Justice and Fed. Trade Comm'n 1992 Horizontal Merger Guidelines, 4 Trade Reg. Rep. (CCH) ¶¶13,104 (1992).

¹⁹ See *NPRM* at ¶133 (market share, supply and demand substitutability, cost structure, size of firm, and control of bottleneck facilities).

(discussed in detail in Section I.B.2 *infra*), made a number of significant determinations regarding what is required to obtain market power in those markets. Under an even-handed application of the same market analysis, there is no plausible basis for a finding that Independent LECs could achieve market dominance in interexchange services.

As Professor MacAvoy explains, the FCC held AT&T non-dominant despite the facts that: (1) AT&T's market share was approximately 55 percent, and was about triple that of the next largest rival; (2) AT&T enjoys price-to-marginal cost margins in the astonishing range of 60 to 70 percent;²⁰ and (3) AT&T's rates *necessarily*, given the FCC's definition of market power, were not above competitive levels.²¹ Despite these factors, the FCC found AT&T non-dominant because: (1) the marketplace is highly elastic regarding both supply and demand; (2) conditions of entry allow almost any carrier to enter the market; and (3) market conditions do not allow AT&T to raise and maintain prices long enough to drive its competitors from the market and still be able to recover any associated losses.²²

The Commission now must apply its policies in an even-handed manner. It follows as a consequence of the *AT&T Non-Dominance Proceeding* that, for the

²⁰ MacAvoy Statement at 21-24 and Table One.

²¹ See also MacAvoy Statement at 12-13 ("No credible theory or empirical evidence exists to support the hypothesis that the GTOCs could profitably carry out a predatory campaign against AT&T, MCI, and Sprint"); accord Spulber Statement at 47 (predatory pricing theory is "discredited" because it is unlikely ever to succeed). It is for such reasons that the Supreme Court has observed that predation is "rarely tried, and even more rarely successful." *Matsushita Elec. Indus. Co. v. Zenith Radio Corp.*, 475 U.S. 574, 589 (1986).

²² See *AT&T Domestic Order* at 3346-3347.

Commission to find an Independent LEC to be dominant, it must conclude that an Independent LEC could: (1) despite entering with a market share of virtually zero in a market found to be competitive, quickly capture more than 55 percent of the market (indicating that supply and demand elasticities in the marketplace just examined by this Commission have changed drastically in the last year); (2) simultaneously charge rates higher than other IXC's; and (3) sustain such a position long enough to recover any associated losses before rivals could force prices down.²³ All this Independent LECs would have to achieve in the face of competition from some of the largest corporations in the world, with well-recognized brand names and vast financial resources. As Professor MacAvoy observes, it would take a "400 fold increase in share" for the GTOCs' long distance market presence to become larger than AT&T's current share.²⁴ Obviously, the likelihood of any of this occurring is remote.

2. Independent LECs cannot achieve market power in interLATA services in view of their market share, the high supply and demand elasticities, the industry's cost structure, and their size.

The Commission found AT&T non-dominant on the basis of an application of the factors that it has long applied in assessing whether carriers are dominant. The same factors lead unavoidably to a conclusion that Independent LECs continue to be non-dominant in interexchange services. Notably, not one of these factors varies in the

²³ MacAvoy Statement at 13.

²⁴ *Id.* at 26. Professor Spulber agrees: "The market shares of individual independent LECs in long distance can be expected to remain negligible in comparison with the IXC's." Spulber Statement at 11.

least depending upon whether the Independent LEC would offer service on an integrated basis or through a separate affiliate.

First, the Commission considers the market share of the carrier. Independent LECs begin with an interexchange market share of zero, or nearly zero.²⁵ As the *Notice* recognizes, new entrants have no ability to raise price directly in the interexchange market, for they have virtually no "output" to "reduce" in order to generate an above-competitive price.²⁶ In comparison, their leading single competitor began the year carrying more than 55 percent of all interstate minutes²⁷ and collecting more than 55 percent of interstate toll revenues.²⁸

Second, the Commission considers supply and demand elasticities. In the *AT&T Non-Dominance Proceeding*, the FCC found that because the interexchange market features high supply and demand elasticities, AT&T's competitors had "sufficient excess

²⁵ GTE Long Distance began offering service early in 1996, starting with a market share of zero. Even today, with a market share well under one percent, GTE Long Distance faces regulatory obstructionism by AT&T, in particular, in a number of states in its efforts to obtain intrastate authority.

²⁶ *NPRM* at ¶133 ("we believe that the fact that each BOC affiliate initially will have zero market share in the provision of in-region, interstate, domestic, interLATA services suggests that the affiliate initially will not be able profitably to raise and sustain its price by restricting its output").

²⁷ *LONG DISTANCE MARKET SHARES: First Quarter 1996*, Industry Analysis Division, Common Carrier Bureau at Table 3 (July 1996).

²⁸ *Id.* at Table 6.

capacity available to constrain AT&T's pricing behavior."²⁹ The same elasticities hold true in the case of entry by Independent LECs.³⁰

Supply elasticity measures: (1) the ability of competitors to easily acquire significant additional capacity in a relatively short time frame; and (2) entry barriers.³¹ The FCC's findings in the *AT&T Non-Dominance Proceeding* apply with even greater force to Independent LECs and in particular to the GTOCs, for they (1) do not typically have necessary interexchange facilities in-place³² and (2) must compete with not only MCI, Sprint, and LDDS WorldCom but also AT&T itself, which all own nationwide, facilities-based networks, as well as with hundreds of smaller resellers.³³ The Commission also held that IXC's such as MCI, Sprint, and the smaller carriers had sufficient capacity to restrain AT&T from setting higher rates.³⁴ *A fortiori*, the incumbent IXC's – which in this analysis now includes AT&T – have even greater capacity and ability to absorb traffic from the Independent LECs, and restrain Independent LECs

²⁹ *AT&T Domestic Order* at 3304. See also MacAvoy Statement at 18-19.

³⁰ See Spulber Statement at 11-14.

³¹ *Id.* at 3303.

³² GTE Long Distance to date is providing service only as a pure, switchless reseller.

³³ *LONG DISTANCE MARKET SHARES: First Quarter 1996*, Industry Analysis Division, Common Carrier Bureau at 3 (July 1996).

³⁴ *AT&T Domestic Order* at 3304.

from setting higher rates. The Commission has also found that "entry into the interstate long-distance market is not prohibited by regulation."³⁵

Nor is demand elasticity an issue. The Commission has found the interexchange market – even for residential customers – highly demand-elastic.³⁶ Independent LECs will face strong competition from AT&T, MCI, Sprint, and over 600 smaller carriers. There is no basis on which to assume that interexchange customers will not readily switch to any of these many other IXCs if an Independent LEC were to charge excessive interexchange prices.³⁷

The third factor – the cost structure of the interexchange industry – also precludes Independent LECs from exercising market power. The interexchange market is characterized by low entry barriers, low marginal costs, and widespread resale services. Just as the Independent LECs can enter as resellers, so can any other carrier.

As for the fourth factor, size, no Independent LEC anywhere approaches the size of AT&T, the largest IXC. AT&T's toll revenues alone for 1995 exceeded \$47 billion,³⁸

³⁵ *Id.*

³⁶ *Id.* at 3305.

³⁷ See also MacAvoy Statement at 30 (stating that "supply and demand elasticities will not decline because of [GTE's] entry").

³⁸ *LONG DISTANCE MARKET SHARES: First Quarter 1996*, Industry Analysis Division, Common Carrier Bureau at Table 6 (July 1996). The Commission recently recognized that a strategy of raising a competitor's costs to eliminate competition, even if feasible, "may not be economically profitable due to its high up-front cost." *COMSAT Corporation*, FCC 96-349 at ¶24 (released Aug. 15,

easily more than twice GTE's *total* revenues from *all* telephone and wireless operations, domestic and international.³⁹ And AT&T, MCI, and Sprint enjoy well-established brand names in interexchange services, a significant obstacle to new competitors.

Each of these factors compels a conclusion of non-dominance. As the *NPRM* notes, however, the FCC will consider a fifth factor – whether the carrier has control of "bottleneck" facilities – in evaluating dominance. Indeed, as presented in the *NPRM*, the entire issue turns on whether or not the Independent LECs can control prices or exclude competition in the interexchange market because they allegedly provide so-called "bottleneck" access facilities. Because of the prominence given this contention in the *NPRM*, GTE will address it in the following section and in Sections II.B.2 and II.B.3 *infra*.

C. Independent LECs' Control Of Allegedly "Bottleneck" Access Facilities Provides No Basis For Dominant Regulation Of Their Interexchange Services.

The *NPRM* solicits comment regarding whether an Independent LEC, absent a *Competitive Carrier* separate affiliate:

would be able to use its market power in local exchange and exchange access services to disadvantage its interexchange competitors to such an extent that it will quickly gain the ability profitably to raise the price of in-region, interstate, domestic, interexchange services significantly above competitive levels by restricting output.⁴⁰

1996). AT&T has sufficient financial resources to defeat any such strategy; furthermore, under the 1996 Act it may provide its own access services.

³⁹ *GTE Annual Report* at 25.

⁴⁰ *NPRM* at ¶157.

The *NPRM* also solicits comment on whether, again in the absence of *the Competitive Carrier* criteria, "an independent LEC would be able to raise its rivals' costs."⁴¹ The short answer to these questions is "no." In addition to the considerations discussed in the preceding section, Independent LECs could not obtain interexchange market power in these scenarios. And even if Independent LECs possessed "bottleneck" access facilities, dominant carrier regulation of their *interexchange* services would be misplaced.

Independent LECs simply do not have the ability to "leverage" any bottleneck facilities to harm interexchange competition.⁴² This is because: (1) Independent LECs face ever-increasing local competition; (2) they provide access services to only a small portion of a national interexchange market; and (3) those access services are subject to close regulation in order to deter precisely such misconduct. GTE believes that, as a matter of law and good economic policy, the FCC cannot justify a finding of dominance for the Independent LECs for interexchange service because of their position in the access market.

⁴¹ *Id.*

⁴² *Accord* MacAvoy Statement at 38 ("After reviewing the theoretical arguments and empirical evidence on these cases, the conclusion is that successful leveraging of market power to long distance cannot be achieved by GTE"); Spulber Statement at 21-29.

1. Alleged "abuses" of Independent LEC access services should be regulated directly, not indirectly through "dominant" regulation in the downstream interexchange services market.

Even assuming, *arguendo*, that Independent LECs had the incentive and the ability to raise the costs of their interexchange competitors and thereby cause rates for interexchange services to rise above competitive levels, dominant carrier classification of their interstate, interexchange services would be a misplaced regulatory "solution." The Commission should not try to regulate indirectly what it already can and does regulate directly in a comprehensive manner.

If, somehow, there were a reasonable probability that Independent LECs could inflict competitive injury on an IXC by manipulating exchange access services, the appropriate regulatory response would be to adopt corrective regulation over the cause – that is, the provision of access services. Dominant regulation of the Independent LECs' *interexchange* services would do absolutely nothing to rectify the alleged discriminatory provision of access services.

Neither the delay in the offering of new services (under Section 214 or the delay before a tariff revision can become effective) nor pricing regulation (especially under a price caps regime) – restrictions applied to dominant interexchange carriers – would have the slightest effect on alleged manipulation of access services. There is simply no match between the perceived harm and the regulatory remedy. Tools other than dominant carrier classification would be far better suited to address the perceived ills.

2. Independent LECs do not have the ability to raise the costs of competing interLATA service providers.

The Commission has expressed concern that an Independent LEC could raise the costs of its IXC competitors by "leveraging" its position in exchange and exchange access services to raise the costs of competitors in the interexchange services marketplace, thereby causing a general increase in price above competitive levels.⁴³ This theory is based on bad economics, as Professor MacAvoy demonstrates,⁴⁴ as well as on fundamental misconceptions regarding the existence of the alleged "bottleneck," the ability of Independent LECs to affect IXC costs and a misunderstanding of their incentives to do so, and an unwarranted lack of faith in federal and state regulations that have worked effectively for years.

a) Section 251 of the 1996 Act eliminated any concerns that the Independent LECs controlled "bottleneck" facilities.

Independent LECs do not possess so-called "bottleneck" access facilities. The 1996 Act eliminated legal barriers to competition for local access services, and the Commission itself recently released extensive, detailed regulations to implement the interconnection provisions of Section 251 of the Act. These regulations require, *inter alia*, unbundling of both local loop and switching services.⁴⁵

⁴³ See, e.g., *NPRM* at ¶¶131, 157-158.

⁴⁴ See MacAvoy Statement at 9-14; see also Spulber Statement at 32-39.

⁴⁵ Professor Spulber observes that the resale and unbundling of local network services under Sections 251 and 252 of the 1996 Act and the continuation of pricing restrictions, geographic rate averaging, and obligations to serve all create

This new environment gives competing LECs a greater opportunity to provide access services in competition with the GTOCs as well as other LECs. This will greatly increase the competition from Competitive Access Providers and other competing LECs ("CLECs") in access and other local services.

The GTOCs, for example, at last count have received 72 requests for interconnection at 53 of their end offices.⁴⁶ CLECs are presently operating in competition with the GTOCs in Oregon and Washington (ELI and MCI Metro), Washington and California (TCG), and Florida (ICI).⁴⁷ AT&T, the largest IXC, has applied for local authority in every state.⁴⁸ This competition is real, is imminent, and creates substantial downward pressure on access rates.

incumbent burdens that "encourage and effectively subsidize" competitive local entry. Spulber Statement at 27.

⁴⁶ A list of the status of negotiations with competing local providers in GTOC states, as of August 1996, is attached as Attachment 2.

⁴⁷ The recently announced merger of LDDS Worldcom and MFS will combine the fourth largest IXC with the largest Competitive Access Provider. *The Wall Street Journal*, "WorldCom Deal Gives 'Local Access' A Buzz," Aug. 27, 1996 at C1. This new company, of course, will have an obvious incentive to use its own facilities to bypass Independent LEC access services.

⁴⁸ An indication of the seriousness of AT&T's move into the local exchange business is its request to regulators in 20 states to arbitrate interconnection agreements between the GTOCs and AT&T. See *Telecommunications Reports*, Volume sixty-two, No. 33, August 19, 1996 at 14. AT&T also has an agreement with Teleport Communications Group to provide access services in nine major cities. This follows agreements made with five other competitive access providers earlier this year. *TR Daily*, "Teleport to Provide Access Services for AT&T," Aug. 26, 1996.

As Professor MacAvoy states, entry by "competitive access providers in service markets that make the largest contribution to [LEC] margin, such as large-volume business local exchange and intraLATA toll, has taken away the local carriers' ability to set terms and conditions for access to the lucrative business and other large-volume subscribers."⁴⁹ This competition also provides a strong disincentive for Independent LECs to discriminate against their largest customers in order to gain some "advantage" in the interexchange services market. Any discrimination by an incumbent LEC against an IXC would merely hasten the shift of that customer away from the LEC to a CLEC.

A LEC could hope to profit from "leveraging" only to the extent that, under the theory expressed in the *Notice*, its increased "profits" in interexchange services exceed its losses in access services, a highly unlikely prospect given the revenues generated by access charges. The IXCs are the LECs' largest customers, and it would take a substantial and sustained above-market interexchange price to offset the revenue losses caused by the departure of an IXC access customer, even viewed from the perspective of the overall company. However, such an offset would simply not occur. Professor MacAvoy explains that in such a scenario the "resulting reduction in demands for access by the interexchange carriers reduces [the LEC's] profits by more than the increase resulting from its own increased sales of interexchange services."⁵⁰ In addition, the Independent LEC simply could not sustain the higher interexchange price, given the high supply and demand elasticities of the interexchange market.

⁴⁹ MacAvoy Statement at 11.

⁵⁰ *Id.* at 12.